PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

ENERGY DIVISION **RESOLUTION E-3846**
November 13, 2003

R E S O L U T I O N

Resolution E-3846. Southern California Edison Company (Edison) requests approval of its Second Gas Supply Plan for the State of California Department of Water Resources (DWR) Tolling Agreements. Edison's Second Gas Supply Plan is approved.

By Advice Letter 1738-E filed August 22, 2003

SUMMARY

This resolution approves Edison's Second Gas Supply Plan (GSP) for DWR tolling agreements, effective on the date of this resolution, subject to the filing of a supplemental advice letter that incorporates the Williams Gas Supply allocated to Edison in D.03-10-016. This second GSP supersedes Edison's GSP approved in Resolution E-3833.

If Edison, despite reasonable efforts, is unable to complete invoice reconciliation within 5 days prior to the invoice date, Edison will notify DWR 5 days prior to the invoice due date.

Edison should procure, on behalf of DWR, sufficient storage capacity to avoid winter imbalance penalties.

Edison shall perform an analysis of storage capacity, injection and withdrawal requirements and develop recommendations prior to SoCalGas' future annual storage solicitations.

Edison shall provide in its next GSP a fuller assessment of the need for interstate or intrastate pipeline capacity rights.

Future Edison GSPs, after the February 1, 2004 filing, that are not protested may become effective after Energy Division review and concurrence.

We will return to General Order 96-A’s 20-day protest period for future GSPs, including the February 1, 2004 filing.

Edison shall file its next GSP on February 1, 2004 for effective dates of April 1, 2004 to September 30, 2004.

BACKGROUND

In D.02-09-053 (the Contract Allocation Order), the Commission allocated thirty-five long-term DWR contracts with twenty-four counterparties to Edison, Pacific Gas and Electric Company (PG&E), and San Diego Gas and Electric Company (SDG&E). SCE was allocated nine of the thirty-five DWR contracts, four of which have gas tolling provisions and are the subject of SCE AL 1738-E.

The Contract Allocation Order determined that the three utilities shall assume operational responsibility for the contracts and are required to:

> "…perform all of the day-to-day scheduling, dispatch and administrative functions for the DWR contracts allocated to their portfolios, just as they will perform those functions for their existing resources and new procurements. Legal title, financial reporting and responsibility for the payment of contract-related bills will remain with DWR."
> (D.02-09-053, page 5)

In D.02-12-069 (the Operating Order decision), the Commission adopted the Operating Order under which the three utilities "will perform the operational, dispatch, and administrative functions for the DWR Contracts as of January 1, 2003,"[1] given that the utilities and DWR were unable, at that point, to negotiate such an agreement on their own.

The purpose of the Gas Supply Plan was set forth in D.02-12-069 (the Operating Order):

> "The utilities are responsible for preparing "Gas Supply Plans" detailing their strategies for procuring gas and proposed use of risk management

[1] D.02-12-069, page 2.

> instruments. These plans will set parameters under which the utilities will perform the various gas-related activities pursuant to the gas tolling provisions. The utilities shall file these plans for Commission approval through Advice Letter filings on a semi-annual basis. The Commission will review and approve these plans on an expedited basis. Following approval of the Gas Supply Plans, the utilities will negotiate with suppliers for gas supplies, transportation, and storage. Negotiated agreements will then be submitted to DWR for execution." (D.02-12-069, page 27)

D.03-04-029 required the three utilities to file their respective Gas Supply Plans on April 17, 2003. Edison subsequently filed its first GSP with AL 1701-E. Resolution (Res.) E-3833, effective July 10, 2003, approved Edison's first Gas Supply Plan (GSP).

Edison re-filed its first GSP in Advice Letter 1701-E-A on July 24, 2003 in compliance with Res. E-3833.

Res. E-3833 required Edison to file its Second Gas supply Plan applicable to the period from October 1, 2003 through March 2004 on August 15, 2003.

Edison met with the Procurement Review Group (PRG) on August 19, 2003 to receive comments on its GSP.

Edison filed Advice Letter 1738-E pursuant to: 1) Decision no. (D.) 03-04-029, which directed Edison to file its initial Gas Supply Plan (GSP) on April 17, 2003, and subsequent GSPs every 6 months thereafter for the term of the Operating Order between Edison and the California Department of Water Resources (DWR); and 2) Res. E-3833, which directed Edison to file its second GSP to reflect modifications discussed in that resolution by August 15, 2003.

On August 13, 2003 the Executive Director of the Commission granted Edison a one-week extension to file its second GSP advice letter with the Commission.

The Operating Order approved in D. 02-12-069 together with its Schedules and Exhibits direct Edison to perform certain activities as DWR's limited agent. In its GSP Edison said that under certain DWR contracts, DWR might exercise the option to provide gas to the underlying generating units rather than have the supplier perform this function. This option is referred to as "tolling".

The Operating Order includes the Commission approved Fuel Management Protocols that detail the operating relationship between DWR and Edison. In its GSP Edison cited Exhibit B of the operating order to illustrate its gas procurement responsibilities:

> "Under the contracts with Fuel Option, upon Utility's determination that Utility will be responsible for procuring the natural gas, Utility shall, acting as the limited agent of DWR, have administrative and operational responsibility for determining its gas procurement strategies, including but not limited to (i) types of contracts, (ii) length of contracts, (iii) pricing terms, (iv) use of storage, (v) types of gas transportation, (vi) delivery points, (vii) whether and how to obtain gas price forecasts, (viii) if and what risk management tools are to be used, and (ix) how to maintain current market intelligence.
>
> Utility shall consolidate these strategies and submit them to DWR and the Commission as a Gas Supply Plan on a semi-annual basis. DWR and the Commission will review and the Commission will approve the Gas Supply Plan. Once approved, Utility may act within that Gas Supply Plan without further DWR involvement…"

Edison's second GSP is basically consistent with the approach used for procurement transactions in its first GSP. Edison's plan includes discussion of strategies involving gas procurement, storage capacity, and risk management tools as well as other topics.

Edison proffers certain gas procurement guidelines for procuring gas under the DWR tolling agreements. These guidelines include:

- With Edison's guidance, DWR will hedge price risk by using Over the Counter (OTC) clearing and margin accounts that DWR has established.

- DWR hedging transactions may include the purchase and sale of New York Mercantile Exchange (NYMEX) natural gas futures and options, and basis trades to hedge the price difference between the delivery point for NYMEX gas transactions (Henry Hub[2]) and the Southern California border.

- DWR procurement activities shall observe a maximum Short-Term (procurement) Transaction volume limit, which is detailed in this GSP and is based on DWR's maximum gas requirements, assuming full dispatch of DWR contracts.

Edison proffers other guidelines relating to natural gas products and transaction processes, the details of which are confidential and shown in Attachment D of the GSP.

Edison cites the following differences between the GSP submitted July 24, 2003 and this second GSP:

- Edison has updated certain procurement details based on current information.

- Edison added new material to address items that Res. E-3833 requested, including a comparison of the countervailing risks presented by short and long term purchases and a proposal for gas storage and minimum storage targets.

Reports Requested by DWR

Edison will provide two additional reports, requested by DWR, in addition to the other reports required by the Operating Order.

1. A monthly Hedging Progress Report that will indicate for each month for the next two years; a) the current estimate of DWR's total gas requirement; b) the volume of gas hedged to date; c) the maximum volume that the GSP

[2] The Henry Hub in southern Louisiana is the principle pricing point for natural gas markets in North America. It is the delivery point for the New York Mercantile Exchange, Inc. Henry Hub natural gas futures contract, the most liquid and transparent pricing indicator for natural gas, and the nexus of 14 intra- and interstate natural gas pipeline systems that draw supplies from the region's gas fields. Ref. www@NYMEX.com.

transaction rate limits allow to be hedged to date; and d) the maximum GSP volume limit.

2. A monthly Stress Case Collateral/Margin Requirement that will estimate, for an assumed and defined procurement strategy and stress case price scenario, DWR's potential collateral and margin requirements for the period of time for which DWR and Edison, as limited agent, are actively procuring gas.

DWR Protocols

With regard to DWR protocols Edison stated its intent to comply with Res. E-3833, page 12, consistent with the following:

DWR will review transactions made pursuant to the parameters set forth in DWR Protocols for compliance with the Protocols. Edison will present confirmations of all gas transactions entered into on behalf of DWR to DWR for DWR's signature.

Edison will provide initial gas invoice reconciliation and payment recommendations to DWR for DWR gas activities such as purchases, sales, storage and transportation. Edison will make reasonable efforts to forward all approved invoices and necessary verification documentation to DWR in accordance with the provisions of the Operating Order no later than 5 business days prior to the due date of the invoice. Also, Edison will make reasonable efforts to forward all rejected invoices, along with an explanation as to why Edison recommends rejecting the invoice to DWR no later than 5 business days prior to the due date of the invoice. If Edison, despite having made reasonable efforts, is unable to complete invoice reconciliation within 5 days prior to the invoice due date, Edison will so indicate to DWR 5 days prior to the invoice due date so that timely payment can be made. Edison will complete the reconciliation process as soon as reasonably possible, and when reconciliation has been competed, Edison will forward its recommendations regarding the invoice to DWR.

Storage as a Hedge Against Natural Gas Price Spikes

Edison addressed the Res. E-3833 requirement that gas storage should be considered as a hedge against high natural gas prices, particularly during the summer months.

Edison explained that natural gas storage is a means to manage daily imbalances throughout the year on a cost-effective basis, to meet gas peaking requirements with cost certainty, to avoid winter balancing penalties, and to provide for limited physical gas supplies in the event of a supply curtailment. Edison said the best opportunity for gas price arbitrage[3] today is to store gas in the summer for withdrawal in the winter, and not withdraw gas in the summer except for daily peaking occurrences. Edison said that DWR's natural gas storage requirements are driven by dispatchable resources[4] whose changing daily gas demands do not necessarily lend them to obtaining firm natural gas pipeline capacity. During the winter months, November through March, SoCalGas' Winter Balancing rules require shippers at a minimum to deliver within 10% of their 5-day burn. Edison said that a 50% penalty applies to deliveries outside of this level. Shortages in natural gas supply are more likely to occur during the winter months, due to the increased demand of natural gas for heating purposes.

Edison is uncertain whether SoCalGas, the only storage provider in Southern California, will sell natural gas storage capacity bundled with firm injection and withdrawal rights, with the ratios of the firm injection and withdrawal rights fixed, or if varying ratios of each can be obtained. Edison said that in either event it would conduct an analysis based on the most current information available in order to determine the recommended quantities and prices for DWR to bid at the time of any SoCalGas storage solicitation. However, Edison qualifies, there is no assurance that DWR will be the successful bidder.

---

[3] Arbitrage involves locking in a riskless profit by simultaneously entering into transactions in two or more markets. Arbitrageurs may also take offsetting positions in two or more instruments to lock in a profit. "Options, Futures and Other Derivatives." 5th Ed. John C. Hull.

[4] Dispatchable resources allocated to Edison include the Alliance Colton, Dynergy and High Desert contracts.

To determine the recommended amount of firm withdrawal rights, Edison proposes to procure on DWR's behalf enough capacity, price permitting, to avoid winter imbalance penalties. SoCalGas assesses a 50% penalty at a minimum to deliveries outside a 10% band for a 5-day burn during the winter season, November through March. Because of the uncertainty of DWR's daily net position and the potential for fluctuations in projected dispatch of DWR dispatchable contracts, Edison recommends procuring sufficient withdrawal rights to keep DWR's gas accounts within the 10% tolerance. Edison will recommend the amounts of storage capacity, injection and withdrawal rights prior to any SoCalGas storage solicitation.

Edison further explains that firm injection rights are needed to avoid penalties in Operational Flow Order[5] situations during the spring and summer months, when the gas pipeline systems may experience overpressurization conditions. Overpresurization occurs primarily on weekends, when demand for natural gas is lower and gas flowing through the pipelines must either be consumed or injected into storage. Based on current information, Edison recommends that DWR procure the maximum difference between the monthly average and minimum forecasted daily gas burns during the spring and summer season. Edison will perform an analysis and develop recommendations prior to any future SoCalGas storage solicitation.

Based on current information Edison's recommended amount of DWR storage inventory is based on the maximum of either: 1) injecting up to the recommended firm injection rights during the weekends of a month, or 2) having to withdraw the recommended firm withdrawal rights for the duration of an assumed gas pipeline outage.[6] Edison said it cannot predict the terms and conditions, or whether the capacity will be available for DWR to secure, but Edison will evaluate capacity requirements before making a recommendation to DWR when specific terms and conditions are known.

---

[5] SoCalGas' Rule 30 F.2. states: "If the Utility determines that transportation nominations received for a specific flow date will result in a period of excess nominations, the Utility shall effectuate at such time a reduction of Hub services that would contribute to the overnomination event and as-available storage injection nominations made for service under Schedule G-AUC."

[6] Gas pipelines typically can be repaired in 7 to 10 days.

Since the outcome of SoCalGas' 2004 storage solicitation is highly uncertain, Edison said it is unable to recommend a minimum storage target for DWR for May 31, 2004 and does not recommend that the commission establish any minimum storage targets for DWR at this time.

Consumer Risk Tolerance

Res. E-3833 required a comparison of countervailing risk of being caught short if the market price of gas skyrockets and the risk of being caught long if the market plummets, and a discussion of the tradeoffs between these kinds of risks.

Edison asserts that D.03-06-067 changed the application of the Consumer Risk Tolerance (CRT) protocol. That decision under section II. 3. states:

> "The Commission's Energy Division staff has reviewed the manner in which each utility applies the CRT protocol and found that [Edison] is misinterpreting how the CRT protocol should be applied. The misinterpretation appears to arise from [Edison] not having access to the confidential evidence the Commission relied on in adopting this mechanism. Staff has explained their findings to the utility and we here provide a detailed explanation of how to apply the mechanism in a revised confidential Appendix B to D.02-12-074 (this Appendix modifies [Edison's] short-term procurement plan for 2003)."

Edison incorporated in its GSP the CRT, as modified by the Commission in D.03-06-067.

Edison's monthly portfolio risk reports that are submitted to the Energy Division and to DWR will indicate the portfolio risk (equal to the cost difference between the expected case portfolio cost and a portfolio cost outcome that has only a 5% probability of being exceeded) and compare that value to the CRT threshold of 1 cent per Kwh. If the portfolio risk exceeds the CRT threshold by 25%, Edison will convene a meeting of its Procurement Review Group.

Gas Industry Restructuring

Edison states that DWR requested some information relating to the Gas Industry Restructuring (GIR), which is under consideration for the SoCalGas system in A.03-06-040. Currently, DWR may bring gas into any one of several receipt points on the SoCalGas system assuming: 1) the availability of capacity on the pipeline (upstream capacity), and 2) the availability of capacity on the SoCalGas system (take away or receipt point capacity). If the total amount of receipt point capacity demanded exceeds the amount available, then DWR's deliveries may be reduced on a pro rata basis with all other parties seeking to use that receipt point. If pro-rata cuts occur, DWR may pay a premium to acquire receipt point capacity at another receipt point. Edison asserts that the GIR attempts to remove the price risk associated with these pro rata costs by requiring users to purchase receipt point capacity in advance; however, such advance purchases remove some of Edison's flexibility in choosing the least cost delivery point for DWR in a fluctuating market and requires DWR to incur additional costs (in the form of payment for advance receipt point rights) to move gas on the SoCalGas system.

Natural Gas Risk Management

Edison uses gas price forecasts in its market assessment. Edison manages DWR contracts with the High Desert Power project, Sempra, Dynergy and Alliance Colton. Edison manages price risk, sudden changes in price; delivery risk, supply interruption or curtailment; volumetric risk, changes in availability of generating plants; and credit risk, the chance that a counter party may not perform as agreed. Edison uses credit exposure management, financial contracts and "netting provisions"[7] to manage such risks.

Besides the physical purchase of gas Edison's strategy includes maximum volume limits for forward[8] transactions, maximum rates of forward purchasing, and a moderate price benchmark to establish rates of gas purchases. Edison combines its physical gas purchases with purchases of various types of financial derivatives. Edison also recommends procurement rights to storage inventory capacity, injection and withdrawal. Edison will recommend sales of gas procured, but no longer needed. Edison can transfer gas purchase obligations between itself and DWR, if one has a surplus gas supply.

[7] Edison states that "netting provisions" involve netting purchases and sales between the two counterparties of a transaction, which reduces the collateral assurance requirements.

[8] A forward contract is an agreement to buy or sell an asset at a certain future time for a certain price. The forward price is the market price that would be agreed to today for delivery of the asset at a specified maturity date. Ref. "Options, Futures and Other Derivatives" - John C. Hull.

NOTICE

Notice of AL 1738-E was made by publication in the Commission's Daily Calendar. Edison states that a copy of the Advice Letter was mailed and distributed in accordance with Section III-G of General Order 96-A.

PROTESTS

No protest was filed against Edison AL 1738-E.

DISCUSSION

We will focus on the additions to Edison's last GSP. This second GSP includes of an update of data and responses to concerns of the Commission staff expressed in Res. E-3833.

Edison's GSP responded to our concerns expressed in E-3833 and generally complies with D.03-04-029. We will therefore approve Edison's GSP. However, as discussed below, Edison should file a supplemental advice letter, as required by D.03-10-016, to incorporate the Williams Gas Supply allocated to Edison starting January 1, 2004.

Interstate Pipeline Capacity

Edison indicates that it will continually assess and recommend to DWR what supply, pipeline capacity, and storage contracts are necessary to ensure sufficiently reliable gas supplies for the DWR Contracts. We did not gain a sense of Edison's assessment of the need for interstate or intrastate pipeline capacity in their GSP. We will require Edison to provide a fuller assessment of the need for interstate or intrastate pipeline capacity in their next GSP. Edison's assessment should include its thinking on whether firm or non-firm pipeline capacity is needed, which pipeline's capacity may be beneficial, and how much capacity should be obtained, if any.

DWR Protocols

Edison will make reasonable efforts to forward all rejected invoices, along with an explanation as to why Edison recommends rejecting the invoice to DWR no later than 5 business days prior to the due date of the invoice. If Edison, despite having made reasonable efforts, is unable to complete invoice reconciliation within 5 days prior to the invoice due date, Edison will so indicate to DWR five days prior to the invoice due date so that timely payment can be made. Edison will complete the reconciliation process as soon as reasonably possible, and when reconciliation has been competed, Edison will forward its recommendations regarding the invoice to DWR. We will approve Edison's proposal for handling invoices.

Gas Storage

In Res. E-3833 we requested that Edison consider the use of gas storage as a hedge against high natural gas prices. Edison explained that natural gas storage is a means to manage daily imbalances throughout the year on a cost-effective basis, to meet gas peaking requirements with cost certainty, to avoid winter balancing penalties, and to provide for limited physical gas supplies in the event of a supply curtailment. Edison said that the best opportunity for gas price arbitrage today is to store gas in the summer for withdrawal in the winter, and not withdraw gas in the summer except for daily peaking occurrences.

Because of the uncertainty of DWR's daily net position and the potential for fluctuations in projected dispatch of DWR dispatchable contracts, Edison recommends procuring sufficient withdrawal rights to keep DWR's gas accounts within the 10% tolerance band of its 5-day burn through the winter months.

Edison made firm recommendations of the amount of gas storage required, however, based on the uncertain outcome of SoCalGas' 2004 storage solicitation, Edison does not recommend a minimum storage target at this time.

We believe that Edison should make every attempt to comply with SoCalGas' winter balancing rules, and we find that Edison's storage strategy is reasonable.

Williams Long Term Gas supply Contract

The Williams long-term gas supply agreement, which became part of the DWR portfolio as a result of the Williams contract renegotiation, and which commences January 1, 2004, was allocated by the Commission to Edison and SDG&E in D.03-10-016. That decision orders Edison to incorporate the Williams Gas Contracts volumes allocated to it in its GSP for the period October 2003 through March 2004. Edison shall file a supplemental advice letter to bring its GSP into compliance with D.03-10-016.

Commission Review

To expedite review of Edison's GSP we required a 10-day protest period. Edison should file its next GSP on February 1, 2004 for an effective date of April 1, 2004 to allow sufficient time for review and comment and to approve it before this GSP expires. With Edison's (and other utilities') next GSP filing, we will return to the normal 20-day protest period. In addition, for future GSPs, we will not require that a resolution be issued for a GSP if the Energy Division fully concurs with the GSP. The Energy Division will advise the Commission of its analysis of future gas supply plans before they are approved

COMMENTS

Public Utilities Code 311(g)(1) provides that this resolution must be served on all parties and subject to at least 30 days public review and comment prior to a vote of the Commission. Section 311(g)(3) provides that this 30-day period may be reduced or waived by Commission adopted rule.

The 30-day comment period was reduced to ensure that Edison's GSP goes into effect in a timely manner consistent with the public interest.

The draft of this resolution was distributed on October 28, 2003 and no comments were received.

FINDINGS

1. Edison filed its second GSP, for the period October 2003 through March 2004, with AL 1738-E.

2. Edison should recommend to DWR that it procure sufficient storage capacity to avoid winter imbalance penalties.

3. Edison should perform an analysis of gas storage, injection and withdrawal requirements and develop recommendations prior to any future SoCalGas storage solicitation.

4. Edison should file its next GSP on February 1, 2004, for the period April 2004 through September 2004. A 20-day protest period should be provided for that advice letter filing.

5. We will not require that a resolution be issued for Edison's future GSPs if the Energy Division fully concurs with the GSP.

6. If Edison, despite reasonable efforts, is unable to complete invoice reconciliation within 5 days prior to the invoice date, Edison will notify DWR 5 days prior to the invoice due date.

7. Edison should provide in its next GSP more information about its assessment of the need for interstate or intrastate pipeline capacity rights.

8. Edison should file a supplemental advice letter to incorporate the Williams gas supply contract into their GSP.

THEREFORE IT IS ORDERED THAT:

1. Edison's second Gas Supply Plan is approved, subject to the filing of a supplemental advice letter that incorporates the Williams gas supply contract.

2. In the future, the Energy Division may approve Edison's Gas Supply Plans, if the Energy Division fully concurs with the GSP.

3. Edison shall file its next Gas Supply Plan on February 1, 2004, for the period April 2004 through September 2004.

4. In its next Gas Supply Plan Edison shall allow a 20-day protest period.

5. Edison shall file in 15 days a supplemental advice letter updating its Gas Supply Plan to comply with D.03-10-016, i.e. to include Edison's allocation of the Williams Gas Supply.

6. In its next Gas Supply Plan, Edison shall provide more information about its assessment of the need for interstate or intrastate pipeline capacity rights, including its assessment of whether firm or non-firm pipeline capacity is needed, which pipeline's capacity may be beneficial, and how much more capacity should be obtained, if any.

This Resolution is effective today.

I certify that the foregoing resolution was duly introduced, passed and adopted at a conference of the Public Utilities Commission of the State of California held on November 13, 2003; the following Commissioners voting favorably thereon:

WILLIAM AHERN
Executive Director

MICHAEL R. PEEVEY
President
CARL W. WOOD
LORETTA M. LYNCH
SUSAN P. KENNEDY
Commissioners

Commissioner Geoffrey F. Brown being necessarily absent did not participate.